IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re PRO PAGE PARTNERS, LLC, Debtor.	No. 00-22856 Chapter 7
MARY FOIL RUSSELL, Trustee, Plaintiff, vs. JOSEPH K. REID, Defendant.	Adv. Pro. No. 00-2027 [affirmed E.D. Tenn. 2:03-CV-226; 08-20-2003]

M E M O R A N D U M

APPEARANCES:

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

This action for the recovery of monies owed based on a personal guaranty is before the court on the parties' cross motions for summary judgment. For the reasons addressed below, the plaintiff's motion will be granted and the defendant's denied. This is a core proceeding. See 28 U.S.C. § 157(b)(2)(A) and (O).

I.

The debtor Pro Page Partners, LLC ("Pro Page") filed for chapter 11 relief on October 23, 2000, and on September 4, 2001, an order was entered converting the case to chapter 7. On April 18, 2002, plaintiff Mary Foil Russell, the chapter 7 trustee, filed a complaint commencing this adversary proceeding against defendant Joseph K. Reid.

As set forth in the complaint, Pro Page was a Tennessee limited liability company engaged in the business of marketing and selling paging and related communication services to customers in East Tennessee. Defendant Reid held a 20% membership or ownership interest in Pro Page which was redeemed on December 30, 1998.

On or about January 17, 1997, Pro Page entered into an agreement with Message Express Paging Company, Inc. ("Message Express"), which, *inter alia*, obligated Pro Page to pay Message

Express the sum of $310,000 for certain assets (the "Agreement"). Contemporaneously therewith, Mr. Reid executed a personal guaranty (the "Guaranty"), guaranteeing Pro Page's indebtedness and obligation to Message Express under the Agreement.

Following the filing of Pro Page's chapter 11 case, Pro Page as debtor in possession commenced an adversary proceeding against Message Express, seeking, *inter alia*, an interpretation of the Agreement and the avoidance and recovery pursuant to 11 U.S.C. §§ 547, 549 and 550 of certain payments made by Pro Page to Message Express under the Agreement. Subsequent to the conversion of this case to chapter 7, the trustee was substituted as plaintiff in the adversary proceeding against Message Express. Thereafter, the trustee and Message Express agreed to a settlement and compromise of the adversary, which was approved by the court after notice and hearing in an order entered December 19, 2001.

The approved settlement provided for the assignment to the trustee of all of Message Express' rights under the Agreement, including all rights of Message Express against Mr. Reid as a guarantor (the "Assignment"). As a result of the Assignment, the trustee made demand upon Mr. Reid for the balance owing under the Agreement. When he refused payment, the trustee

instituted the present adversary proceeding. The trustee alleges in the complaint that she is entitled to recover from Mr. Reid "the sum of $245,562.98 which is the principal balance under the Agreement, together with all accrued and unpaid interest thereon and the out-of-pocket expenses and attorney's fees incurred by Message Express and the plaintiff in enforcing the terms of the Agreement."

On January 10, 2003, the trustee filed a motion for summary judgment, alleging that there is no genuine issue of material fact and that she is entitled as a matter of law to judgment against Mr. Reid. The motion is supported by the affidavit of Robert Bradford Wallace, the president of Message Express, and a memorandum of law. In his affidavit, Mr. Wallace reiterates the allegations of the complaint and states that as of Pro Page's bankruptcy filing on October 23, 2000, the unpaid principal balance owed Pro Page to Message Express under the Amendment was $208,930.49; that with contractual interest of 8%, accrued interest of $39,399 was due as of December 31, 2002, for a total balance on that day of $282,829.49, with interest continuing to accrue at the rate of $56.49 per day; and that Message Express paid attorney fees of $27,738.22 "for services rendered on behalf of Message Express relative to the

enforcement of the Agreement in the Pro Page bankruptcy case."* Attached to the affidavit are copies of the Agreement, the Guaranty, the assignment from Message Express to the trustee, and a statement of attorney fees paid by Message Express.

On February 18, 2003, Mr. Reid filed a response to the trustee's motion and a cross motion for summary judgment. Mr. Reid contends he is entitled to judgment in his favor because (1) the settlement between the trustee and Message Express released Pro Page's liability under the Agreement thereby extinguishing his liability as guarantor; and (2) he has both a common law and contractual right of indemnification from Pro Page for any sums which he pays with respect to the Guaranty, entitling him to a dollar-for-dollar offset. On March 7, 2003, the trustee filed a reply to Mr. Reid's summary judgment motion in which she, not surprisingly, disagrees with his contention that he is entitled to summary judgment.

II.

Rule 56 of the Federal Rules of Civil Procedure, as incorporated by Fed. R. Bankr. P. 7056, mandates the entry of

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*Under the court's calculations, these amounts are mathematically incorrect. The sum of $208,930.49 and $39,399 is $248,329.49, not $282,829.49. The court also questions the interest rate per diem calculation.

summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." "When reviewing cross-motions for summary judgment, the court must evaluate each motion on its own merits and view all facts and inferences in the light most favorable to the nonmoving party." *Wily v. United States (In re Wily)*, 20 F.3d 222, 224 (6th Cir. 1994).

III.

The court will first address Mr. Reid's assertion that his obligations under the Guaranty have been extinguished by the settlement between the trustee and Message Express. Mr. Reid's argument in this regard is summarized on page 5 of his memorandum of law wherein he states:

> [T]he Assignment absolutely assigns all rights of Message Express under the Agreement to Plaintiff, on behalf of Pro Page. Such an absolute assignment constitutes an express release of the obligation owed to Message Express, discharging Pro Page and the estate of its indebtedness and barring Message Express from any further pursuit of Pro Page or the estate under the Agreement. That discharge of the principal obligor in turn discharged Defendant, the guarantor of the Agreement.... Given that Message Express has released the obligation of Pro Page through the Assignment, Pro Page is no longer liable to Message Express. Moreover, even if Plaintiff argues that she

> has stepped into the shoes of Message Express by the Assignment, Defendant still has no obligation to Plaintiff because Plaintiff has no obligation to itself; that is a legal impossibility.

In support of this argument, Mr. Reid cites *Wallace Hardware Co. v. Abrams*, 223 F.3d 383 (6th Cir. 2000), for the general proposition that "a guarantor's liability is commensurate with the outstanding indebtedness of the principal debtor." *Id.* at 407. Mr. Reid also states that "[t]he general rule is that satisfaction of the principal obligation discharges the guarantor," citing 38 C.J.S. *Guaranty* 77; *Holcombe v. Solinger & Sons Co.,* 238 F.2d 495 (5th Cir. 1956); "because 'the liability of the guaranty is measured by the liability of the principal. If the principal is not liable, then the guarantor may not be held. *Savin Corp. v. Copy Distributing Co., Inc.*, 716 S.W.2d 690, 692 (Tex. App. 1986).'"

The trustee's response to Mr. Reid's extinguishment argument is that Pro Page's obligation to Message Express under the Agreement was not released or discharged in the settlement; instead, the only claims settled and compromised were those asserted in the adversary which revolved around the status of the Agreement as an executory contract and the trustee's claims for recovery of preferential and postpetition transfers. Alternatively, the trustee asserts that even if the settlement

discharged Pro Page's obligations to Message Express, such settlement did not extinguish Mr. Reid's liability under the Guaranty due to the express terms of the Guaranty. Lastly, as to the assertion that by stepping into the shoes of Message Express, the trustee extinguished the obligation because an obligation to herself is a legal impossibility, the trustee distinguishes between herself and the debtor, noting that as trustee she is acting on behalf of creditors of the estate rather than the debtor.

In *Wallace Hardware Co.*, the Sixth Circuit Court of Appeals did recite as a basic principle of guaranty law that a guarantor is liable only to the extent that the principal debtor is liable. *See Wallace Hardware Co.*, 223 F.3d at 401. However, the court went on to state:

> There are circumstances ... in which a discharge of the principal debtor's liability does not extinguish the guarantor's liability. For instance, the terms of the guaranty itself may permit a creditor to compromise a claim against the principal debtor without discharging the guarantor's liability, and the courts generally will enforce such terms.

Id. at 401-02.

The court noted that the guaranty before it fell within this exception because it stated that "Guarantor authorizes Wallace, without notice or demand and without affecting Guarantor's liability hereunder, from time to time to (a) renew, compromise,

extend, accelerate or otherwise change the time for payment of, or otherwise change the terms of the indebtedness or any part thereof." *Id.* at 402. In light of this language, the court concluded that "Wallace Hardware [the creditor] was free to compromise its claims against Tri-County [the principal obligor] without relinquishing its right to recover any remaining indebtedness from the Abrams brothers as guarantors." *Id.* at 405.

In the present case, it is not clear that the settlement and compromise between the trustee and Message Express released Pro Page's liability to Message Express under the Agreement. The motion to compromise filed by the trustee on November 23, 2001, states regarding releases that "[t]he pending adversary proceeding will be dismissed with prejudice and the Trustee and Message Express will execute mutual releases regarding all claims asserted in such adversary proceeding." As previously noted, the trustee's complaint in that adversary proceeding sought recovery of allegedly preferential and avoidable postpetition payments made by the debtor to Message Express. In answer to that complaint, Message Express denied that the trustee was entitled to relief and asked that it be awarded its costs and expenses in defending the action. Message Express did not, however, counterclaim for the sums owed to it by the debtor

Pro Page under the Agreement.

Nonetheless, even if it were inferred that the settlement or Assignment constituted a de facto release or compromise of Pro Page's liability to Message Express under the Agreement, it does not follow that Mr. Reid's liability under the Guaranty is extinguished. Instead, as in *Wallace Hardware Co.*, the Guaranty in the present case expressly permits a settlement between the creditor and principal obligor without effecting a discharge of the guarantor's debt. The first paragraph on the second page of the Guaranty provides:

> Guarantor hereby agrees that Message Express Paging Company, Inc., may extend time for payment under the Agreement or otherwise, settle, compromise or otherwise deal with Debtor or any other person for payment of the indebtedness under the Agreement or otherwise. Upon default of the Debtor under the Agreement, notwithstanding any actual or asserted invalidity or unenforceability of the indebtedness as against the Debtor, Message Express Paging Company, Inc., may, at its option, proceed directly and at once, without notice, against Guarantor to collect the indebtedness or any portion thereof under the Agreement or otherwise.

Thus, under the express terms of the Guaranty executed by Reid, Message Express was free to settle or compromise its claim against Pro Page without relinquishing its right to recover the balance owed to it under the Agreement from Mr. Reid as guarantor.

The facts of *Wallace Hardware Co.* are especially instructive

in this regard. In *Wallace Hardware Co.*, as in the present case, the bankruptcy trustee sued the creditor to recover certain preferential transfers by the debtor to the creditor pursuant to a certain operating agreement. After that suit was settled by the payment of $128,000 by the creditor to the trustee, the creditor sought to recover the $128,000 payment from the guarantor of the debtor's obligations to the creditor under the operating agreement. *Wallace Hardware Co.,* 223 F.3d at 407. The Sixth Circuit rejected the guarantor's argument that the settlement between the creditor and the trustee discharged the guarantor's obligations, stating:

> Wallace Hardware [the creditor] was permitted, under the terms of the Guaranty, to proceed directly against the guarantors without making any effort to collect from Tri-County [the debtor]. Likewise, under the Guaranty, Wallace could have opted not to file a claim in the bankruptcy proceedings—or, alternatively, could have compromised this claim—without in any way impairing its right to recover any outstanding indebtedness from the Abrams brothers.

Id. at 409. *See also Hickory Springs Manufacturing Co. v. Evans*, 541 S.W.2d 97 (Tenn. 1976) (Because guaranty agreement provided that liability of guarantor would not be affected by settlement or compromise, creditor's release of the principal did not discharge the liability of the surety.). Accordingly, based on the foregoing, the court concludes that Message Express' claim against Mr. Reid arising out of the Guaranty was

not discharged by Message Express' settlement with the trustee.

The only other issue in this regard is whether Message Express' claim against Mr. Reid was extinguished by its assignment to the trustee. As asserted by Mr. Reid in his memorandum of law, "even if Plaintiff argues that she has stepped into the shoes of Message Express by the Assignment, Defendant still has no obligation to Plaintiff because Plaintiff has no obligation to itself; that is a legal impossibility."

Mr. Reid's argument incorrectly assumes that the trustee, in bringing this action, is the representative or successor in interest to the debtor Pro Page. The Sixth Circuit Court of Appeals has observed that "[a] bankruptcy trustee is the representative of all creditors of the bankruptcy estate.... As such the Trustee is not simply the successor-in-interest to the Debtor: he represents the interest of all creditors of the Debtor's bankruptcy estate." *Corzin v. Fordu (In re Fordu)*, 201 F.3d 693, 705 (6th Cir. 1999). In bringing this adversary proceeding, the trustee is asserting a claim which was assigned to her in her capacity as representative of this bankruptcy estate and its creditors. To argue that she and the debtor are one in the same misstates the nature and legal status of a bankruptcy trustee. Accordingly, Mr. Reid's argument in this regard is without merit.

Mr. Reid's second basis for summary judgment in his favor is his indemnification argument. Mr. Reid maintains that he has both a contractual and common law right of indemnification from Pro Page for any sums which he is required to pay Message Express and this indemnification right would offset any liability owed to the trustee. Mr. Reid states in his memorandum of law that his common law indemnification assertion is derived from the equitable principle that "[i]f a guarantee is enforced, the original obligor is liable to the guarantor for the amounts required to be paid," citing, *inter alia, Fredericks v. Shapiro*, 160 F.R.D. 26, 28 (S.D.N.Y. 1995). Mr. Reid's contractual indemnification claim arises out of a Redemption and Indemnification Agreement entered into on or about December 30, 1998, between Mr. Reid, Pro Page, and certain other individuals (the "Indemnification Agreement"). In this document, Mr. Reid is identified as one of the "Sellers" and Pro Page as the "Company." The "Whereas" clauses recite that each Seller holds a 20% membership interest in the Company, that the Sellers desire to sell and the Company redeem these membership interests, and that the Sellers desire to be held harmless from certain liabilities of the Company. Paragraph 3 of the Indemnification Agreement, entitled "Indemnification" provides the following:

> The Company ... agree[s] to defend, indemnify, and hold Sellers harmless from and against any and all liability, claims, demands, damages, obligations or debts asserted against Sellers as a result of the operation of the Company and/or the Company's business, including, without limitation, any liability asserted against Sellers arising from personal guaranties to Kenesaw Leasing.

The court will assume for purposes of this memorandum opinion that Mr. Reid would have an indemnification or subrogation claim against Pro Page's bankruptcy estate in the event he made payment under the Guaranty. *See* 11 U.S.C. § 509(a). The mere existence of a claim, however, does not establish the second premise of Mr. Reid's argument: that this claim would offset in its entirety the trustee's claim against him arising out of the Assignment.

Section 553 of the Bankruptcy Code addresses setoff in the bankruptcy context. *In re Bourne*, 262 B.R. 745, 748 (Bankr. E.D. Tenn. 2001). It provides in part the following:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case ....

The United States Supreme Court has noted that § 553 does not create a federal right of offset; it only preserves in bankruptcy whatever right otherwise exists. *Citizens Bank of*

Maryland v. Strumpf, 516 U.S. 16, 18 (1995). Section 553 preserves the right of setoff where the following four elements are established:

> (1) A debt owed by the creditor to the debtor which arose prior to the commencement of the bankruptcy case;
>
> (2) A claim of the creditor against the debtor which arose prior to the commencement of the bankruptcy case;
>
> (3) The debt and the claim are mutual obligations; and
>
> (4) A right to setoff the debts under nonbankruptcy law.

In re Holder, 182 B.R. 770, 775 (Bankr. M.D. Tenn. 1995).

Application of these elements to the present case immediately reveals that Mr. Reid's setoff argument fails due to the absence of the first element, i.e., a prepetition debt owed by Mr. Reid to the debtor Pro Page. While Mr. Reid's obligation under the Guaranty arose prepetition upon execution of the Guaranty, the obligation was to Message Express rather than the debtor. The fact that the obligation has been assigned by Message Express to the debtor's bankruptcy trustee does not affect this analysis. As previously observed, the trustee and the debtor are not the same entities. The trustee, as representative of the bankruptcy estate, is pursuing this adversary proceeding as an assignee of Message Express, not as

a successor-in-interest to the debtor. As such, the fact that Mr. Reid's debt to Message Express has been assigned to the debtor's bankruptcy trustee does not render the debt owed to the debtor. Because Mr. Reid does not have a right of setoff under § 553 of the Bankruptcy Code, his alleged indemnification claim does not constitute a defense to the present adversary proceeding.

Before closing, the court observes that its rejection of Mr. Reid's defenses does not work an injustice as he suggests in his answer by invoking equitable principles. In signing the Guaranty, Mr. Reid obligated himself to Message Express for Pro Page's obligations under the Agreement, regardless of whether these obligations were compromised or settled. Even if Message Express had not assigned its claim to the trustee, Mr. Reid would still have been liable to Message Express for the balance owing under the Agreement and in the event of payment would only have a claim against Pro Page's estate. The Sixth Circuit Court of Appeals in *Wallace Hardware Co.* stated "the general rule that a discharge in bankruptcy does not affect a guarantor's liability." *Wallace Hardware Co.,* 223 F.3d at 402 (citing, *inter alia, Moore, Owen, Thomas & Co. v. Coffey*, 992 F.2d 1439, 1449 (6th Cir. 1993); 11 U.S.C. § 524(e)). Based on this principle and the terms of the guaranty agreement which

expressly permitted a compromise of the underlying indebtedness, the Sixth Circuit observed "Tri-County's indebtedness to Wallace Hardware could have been completely discharged without affecting the liability of the guarantors." *Id.* at 405-06.

Furthermore, if the trustee had pursued the adversary proceeding against Message Express to completion and obtained a recovery from Message Express of preferential and avoidable postpetition payments made by Pro Page to Message Express under the Agreement, Mr. Reid would have been liable to Message Express under the Guaranty for these payments, in addition to being liable for the Agreement balance. *Id*. at 408 ("[T]he courts have uniformly held that a payment of a debt that is later set aside as an avoidable preference does not discharge a guarantor of his obligation to repay that debt."). Thus, while it may be of little consolation to Mr. Reid, absent the settlement between the trustee and Message Express, his liability arising out of the Guaranty could have been greater than that sought in this action.

IV.

In light of the foregoing, the defendant's motion for summary judgment will be denied in all respects. As to the plaintiff's motion for summary judgment, no genuine issue of

material fact has been raised and it appears that the plaintiff is entitled to judgment as a matter of law. The exact amount of the judgment will be addressed in an order entered contemporaneously with the filing of this memorandum opinion.

FILED: March 20, 2003

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE